IN *AURORA*, SECURITIES REGULATORS AFFIRM THE NEW TAKE-OVER BID REGIME AND SIGNAL THAT EXEMPTIVE RELIEF UNDER THE NEW REGIME WILL PROVE TO BE DIFFICULT AND THAT TACTICAL SHAREHOLDER RIGHTS PLANS MAY BE EXTINCT

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The Ontario Securities Commission ("**OSC**") and the Financial and Consumer Affairs Authority of Saskatchewan ("**FCAAS**") (collectively, the "**Panel**") recently released their collective reasons ("***Re Aurora***")[1] for the orders granted in December, 2017 following a hearing concerning the hostile take-over bid by Aurora Cannabis Inc. ("**Aurora**") for all the common shares of CanniMed Therapeutics Inc. ("**CanniMed**").[2]

The reasons relate to the orders granted by the Panel on December 22, 2017 to: (i) cease trade CanniMed's shareholder rights plan ("**Rights Plan**"); (ii) reject Aurora's application to reduce the deposit period; (iii) reject CanniMed's applications to restrict Aurora's ability to make open market purchases of common shares of CanniMed and to deem Aurora to be acting jointly and in concert with certain shareholders of CanniMed (the "**Locked-up Shareholders**"); and (iv) order Aurora to amend its take-over bid circular to make disclosure of certain information regarding a CanniMed board meeting where an acquisition was being considered.

Re Aurora is the first decision by securities regulators to consider both an application to cease trade a tactical rights plan[3] and an application for exemptive relief under the new take-over bid regime ("**New Regime**") set out in National Instrument 62-104 - *Take-Over Bids and Issuer Bids* ("**NI 62-104**"). If there is one lesson to come out of *Re Aurora*, it is the strength of the regulators' commitment to the New Regime and its requirements.

The hearing occurred in the context of competing visions for the future of CanniMed, one of Canada's oldest licensed medical cannabis producers, in the face of pending legalization of recreational cannabis. CanniMed, which had been the sole producer of medical cannabis for the Canadian Government for more than 13 years, sought to strengthen its market position by acquiring Newstrike Resources Ltd. ("**Newstrike**"), a company entering the recreational use cannabis market.

CanniMed's largest shareholders disagreed fundamentally with the board's acquisition strategy. These shareholders believed that CanniMed should instead seek out a business combination with another Canadian

licensed producer. While CanniMed strongly pursued the Newstrike acquisition (which would leave shareholders of CanniMed holding 65%, while shareholders of Newstrike would hold 35%, of the combined entity on a fully diluted basis), its principal shareholders sought out what they believed was a more beneficial transaction for long-term value. These Locked-up Shareholders entered into "hard" lock-up agreements[4] with Aurora in mid-November, 2017. At the time, Aurora was the number two cannabis producer in Canada by market capitalization and had aggressively been rolling out an expansion strategy.

Upon entering in the lock-up agreements, Aurora immediately approached CanniMed seeking a "friendly" combination – albeit with a limited time to respond. Just over a week later, on November 17, 2018, CanniMed announced the finalization of an arrangement agreement pursuant to which CanniMed would acquire Newstrike. On November 20, 2017, Aurora announced its intention to take its offer directly to CanniMed's shareholders. CanniMed called a special meeting of its shareholders to approve the Newstrike acquisition for January 23, 2018. One day following the notice of meeting, CanniMed announced that it had formed a special committee tasked with evaluating the Aurora offer ("**Special Committee**"). The Special Committee rejected Aurora's proposal to acquire CanniMed.

Rebuffed by the CanniMed board, Aurora made a bid on November 24, 2017 to acquire all of CanniMed's common shares subject to a maximum of $24 per common share of CanniMed, payable in common shares of Aurora. The Aurora offer was conditional on CanniMed not proceeding with the Newstrike acquisition.

Faced with the Aurora offer, the CanniMed board hastily adopted the Rights Plan on November 28, 2017, the day before Aurora could begin to make permitted market purchases of CanniMed's common shares pursuant to the exemption ("**5% Exemption**") available in section 2.2(3) of NI 62-104. The 5% Exemption provides a limited exception to the prohibition against bidders purchasing target shares outside of a take-over bid provided that certain conditions are met. In effect, the Rights Plan sought to prevent Aurora from either acquiring any common shares of CanniMed under the 5% Exemption by deeming Aurora to own all the common shares held by the Locked-up Shareholders, or entering into additional lock-up agreements with shareholders of CanniMed.

The competing transactions culminated in each of CanniMed, the Special Committee and Aurora submitting applications to the OSC and FCAAS in December, 2017 seeking various forms of relief. The Special Committee was granted full intervenor status in the proceedings. However, the Panel noted that its decision should not be read as sanctioning full intervenor status for special committees in all such circumstances.

Aurora applied to shorten the initial 105 day deposit period to 35 days on the basis that the Newstrike acquisition was, in spirit, an "alternative transaction". Pursuant to section 2.28.3 of NI 62-104, in the event an issuer is pursuing an "alternative transaction", the bid window can be shortened to a minimum of 35 days.

Aurora's application also requested a cease trade order against the Rights Plan. CanniMed requested that Aurora be denied use of the 5% Exemption, and the Special Committee applied to have Aurora be held to be acting jointly or in concert with the Locked-up Shareholders.

Due to a variety of factors, in March, 2018, Aurora acquired CanniMed in a friendly transaction which represents the largest Canadian M&A transaction in the cannabis sector to date. Mid-January 2018, the parties began discussing a potential friendly transaction, which led to an agreement on January 24, 2018. Aurora agreed to increase the offer price for common shares of CanniMed and CanniMed terminated the arrangement agreement with Newstrike.

THE NEW REGIME

The Panel's reasons emphasize the importance of the rebalancing of the take-over bid regime, and how elements of the New Regime work together to promote shareholder choice and predictability. The findings of the Panel also emphasize the importance of lock-up agreements, particularly in light of the requirement under the New Regime to not take up and pay for shares unless a majority of the shares subject to the bid have been tendered.

1. 105 DAY PERIOD

CanniMed's shareholders were to consider the Newstrike acquisition well before the 105 day initial deposit period required for the Aurora offer under the New Regime would expire. Aurora requested exemptive relief to shorten the 105 day period to at least 35 days, submitting that shortening the bid window would give CanniMed's shareholders the ability to compare and choose between the Aurora offer and the Newstrike acquisition in circumstances where CanniMed was pursuing no other options and had solicited its shareholders to choose the Newstrike transaction as a more favourable alternative to the Aurora offer.

The Panel found that the policy rationale for the "alternative transaction" exemption in NI 62-104 did not exist in this situation. The Panel confirmed the narrowness of the exemption and that it is only applicable when elements of an "alternative transaction" are strictly met. The definition of "alternative transaction" is intended to encompass "friendly" transactions that are agreed to or initiated by the issuer and which could result in an acquisition of the issuer or business of the issuer as an alternative to doing so by means of a take-over bid. Typically, this will involve a change of control involving a plan of arrangement or an amalgamation (or similar transaction) where the result is that the target shareholders' interests in the issuer are extinguished. Where the exemption applies, the shortened deposit period allows the target's shareholders to concurrently consider and choose between the bidder's offer and the target's transaction.

The Newstrike acquisition did not meet the strict definition of "alternative transaction" because it would not

extinguish CanniMed's shareholders' interests nor would it result in a change of control of CanniMed. The Panel refused to classify the Newstrike acquisition as an "alternative transaction" in spirit and focused on the following factors in making such finding:

- the magnitude of the break fees in the Newstrike acquisition were a limited deterrent to the Aurora offer. They were not a substantive obstacle and did not preclude consideration of unsolicited offers or an offer following the Newstrike acquisition;
- Aurora could revisit its self-imposed condition that its offer was conditional on CanniMed shareholders rejecting the Newstrike acquisition; and
- the Newstrike acquisition had been under consideration for a lengthy amount of time, and therefore, was not a defensive tactic taken in response to the Aurora offer.

Ultimately, the Panel concluded that it was not necessary to shorten the 105 day period in order to facilitate shareholder choice. The rebalancing in the New Regime gives the boards of target companies greater time to respond to bids. Preserving the longer bid window allowed CanniMed to receive superior offers even though the board was not yet engaged in an auction process. The Panel refused to make "piecemeal changes" to timing requirements that affect planning and may make bid pricing and secondary market price determinations less predictable. The Panel held that investors and market participants are entitled to know with reasonable certainty what rules will govern the bid environment. Accordingly, predictability under the New Regime is paramount.

As a result, it will be highly unlikely that securities regulators will agree to shorten a bid window for transactions that do not strictly meet the relatively narrow definition of "alternative transaction", unless the transaction goes directly against the spirit of the exception (and results in the acquisition of the issuer or the business of the issuer, including for example, a change of control transaction) or engages National Policy 62-202 – *Take-Over Bids – Defensive Tactics* ("**NP 62-202**") as a defensive tactic. Despite the Panel's decision, we have no doubt that this will not be the last time the securities regulators will be asked by a bidder to consider shortening of the bid window in circumstances where a transaction does not squarely meet the definition of "alternative transaction".

2. CEASE TRADING THE SHAREHOLDER RIGHTS PLAN

The Panel held that the Rights Plan adopted by CanniMed's board was an improper defensive tactic pursuant to NP 62-202. Accordingly, it exercised its public interest jurisdiction to cease-trade the Rights Plan. The Panel accepted that the Rights Plan was created to thwart the Aurora offer and to protect the Newstrike transaction. In coming to its decision, the Panel noted that there was no evidence that CanniMed was seeking other transactions or that the Rights Plan was operating to give the board of CanniMed time for higher bids to

emerge.

The Panel agreed with Aurora that the Rights Plan could operate to deny CanniMed shareholders the potential benefits of the Aurora offer because it would have prevented Aurora from entering into additional lock-ups agreements or purchasing common shares of CanniMed in the marketplace pursuant to the 5% Exemption.

The rebalancing of the take-over bid regime, reflected in the requirements of the New Regime, provides sufficient protection of shareholder choice by giving management adequate time to respond to an unsolicited bid in an appropriate, predictable, and even-handed manner. Therefore the legitimate use of tactical shareholder rights plans is virtually non-existent and past proceedings dealing with shareholder rights plan are no longer relevant.

The Panel implied that a tactical shareholder rights plan that seeks to do any or all of the following will be struck down upon application to the securities regulators:

- simply reproduces the elements of the New Regime (as this is confusing and serves no useful purpose);
- deems ownership of shares subject to lock-ups unless there is a finding of parties acting jointly or in concert; or
- prevents the use of the 5% Exemption.

Though the securities regulators kept the door open for a tactical shareholder rights plan to be used in the future even if it interferes with the New Regime, the Panel made clear this type of circumstance would be very rare. The Panel did not address the impact of its findings on non-tactical shareholder rights plans, the vast majority of which deem shares subject to hard lock-ups to be beneficially owned and which would prevent the use of the 5% Exemption in many circumstances. Accordingly, it remains to be considered whether a non-tactical shareholder rights plan would be upheld following a hostile take-over bid if it prevents the use of the 5% Exemption by deeming beneficial ownership of securities subject to hard lock-ups or simply as a result of a bidder owning 20% or more of the outstanding shares. In our view, customary non-tactical plans may be subject to different analyses since NP 62-202 is not engaged when such a plan is implemented.

3. THE 5% EXEMPTION

The Panel reiterated that the 5% Exemption is an established feature of the take-over bid regime. It referenced the policy reasons for the 5% Exemption set out in *Re Falconbridge Ltd.*[5], including assistance to the liquidity of the securities of the target, providing shareholders of the target with an equal opportunity to sell their securities prior to conclusion of the bid, raising the market price of the securities and encouraging bidders to raise their offer prices. The Panel then noted that the policy reasons for the exemption were only considered in *Re Falconbridge* because the bidder held 19.8% of the issued and outstanding common shares and, together

with the use of the 5% Exemption and its ability to waive its minimum share condition, could have obtained a blocking position that would have prevented shareholders from participating in a control premium. The Panel then went on to distinguish the facts in *Re Aurora* from those in *Re Falconbridge*. Aurora did not own any common shares of CanniMed and the New Regime required a minimum tender condition which mitigates the risk that shareholders will be denied the ability to participate in a control premium. Notably, the Panel was not prepared to consider the impact of the hard lock-up agreements in this context, unless Aurora was acting jointly or in concert with the Locked-up Shareholders.

Considerations such as those in *Re Falconbridge* will now only be relevant, and the 5% Exemption removed, if elements of the New Regime are otherwise undermined – such as preventing shareholders from participating in a control premium. Only in those circumstances will the securities regulators consider exercising their public interest jurisdiction to deny use of the 5% Exemption.

4. ACTING JOINTLY OR IN CONCERT AND DISCLOSURE ISSUES

CanniMed stridently objected to the circumstances leading to the Aurora offer and the Special Committee sought a finding that the Locked-up Shareholders were acting jointly or in concert with Aurora under section 1.1 of MI 61-101 – *Protection of Minority Security Holders in Special Transactions* ("**MI 61-101**"). If the Panel had found that Aurora and the Locked-up Shareholders were joint actors, the balance in the battle for control would have shifted in favour of CanniMed by excluding the common shares subject to the Lock-up Agreements from the minimum tender condition for the Aurora offer and making the Aurora offer an insider bid requiring, among other things, a formal valuation.

The Panel affirmed that whether parties are "acting jointly or in concert" under section 1.9(1) of NI 62-104 or are "joint actors" under section 1.1 of MI 61-101 is a question of fact and involves identical considerations. The initial onus of establishing that a bidder and shareholders are joint actors lies with the party making the allegation.

Section 1.9(1)(a) of NI 62-104 states that a person is deemed to be acting jointly or in concert with an offeror if, as a result of any agreement, commitment or understanding with the offeror, that person acquires or offers to acquire securities of the same class as those subject to the offer. Further, section 1.9(1)(b) of NI 62-104 states that a person is presumed to be acting jointly or in concert with an offeror if such person, as a result of an agreement, intends to exercise jointly or in concert with the offeror, any voting rights attaching to any of the securities of the target. However, pursuant to section 1.9(3) of NI 62-104, parties do not become joint actors solely because they enter into a lock-up or support agreement with an offeror to tender securities to a bid.

The Panel considered the 2007 OSC decision in *Re Sterling Centrecorp Inc.*[6] and agreed that evidence of a formal agreement between the parties is helpful, but not necessary to make a joint actor finding. The real question remains whether or not the parties are acting together to bring about a "planned result".

Furthermore, the Panel reiterated that section 1.9(3) of NI 62-104 does not distinguish between hard lock-up agreements and soft lock-up agreements. Notably, the Panel emphasized the importance of lock-up agreements as both an established and legitimate practice in M&A transactions and highlighted their importance in the New Regime in particular, since the longer bid window and minimum tender condition expose bids to more deal risk.

Any presumption that an agreement to exercise voting rights leads to joint actor status with a bidder can be rebutted where the voting rights are tailored to be consistent with and to support otherwise permissible shareholder commitments to tender securities to a bid. In this case, the Locked-up Shareholders did not agree to vote in accordance with Aurora's instructions and did not give up their proxies to Aurora. They remained self-interested sellers in a transaction on the opposite side of Aurora.

Regulators have long accepted that information is exchanged in the negotiation process of a lock-up agreement between the parties. Such communications, similar to the actual agreements themselves, do not automatically lead to a finding of joint actor status. The Panel emphasized that locked-up shareholders may be joint actors with a bidder where their cooperation with the bidder goes beyond seeking to maximize the price and liquidity for their shares. For example, the transfer of material non-public information in a clear and extensive manner could reflect a level of cooperation that places shareholders 'under the tent' with the bidder in the planning process, and lead to a finding of acting jointly or in concert.

The Panel held that Aurora's receipt of information regarding the timing of a CanniMed board meeting and the general characteristics of the acquisition target being considered by CanniMed constituted material non-public information. Aurora's receipt of such information, however, was cleansed by disclosure of both Aurora's offer and the Newstrike acquisition. Moreover, the transfer of information did not lead the Panel to a finding that the Locked-up Shareholders were seeking anything other than the highest price for their securities, nor did Aurora make purchases of CanniMed common shares based on the information. As a result, the Panel ordered Aurora to disclose in a notice of change to its take-over bid circular the circumstances that led to it becoming aware of the CanniMed board meeting in which the arrangement agreement with Newstrike was to be considered for approval, which Aurora complied with.

This decision makes clear that care needs to be taken in the negotiation of lock-up agreements to ensure that they are drafted in a manner that protects the deal. Hard lock-ups are acceptable, however, if the agreements contain a proxy over voting rights or give additional benefits to the locked-up shareholder (including for example, a board seat), parties will be subject to increased risk of being found to be acting jointly or in concert.

CONCLUSION

The rebalancing of the take-over bid regime promotes shareholder choice and predictability. Accordingly, the

key takeaways from the Aurora-CanniMed decision are:

- it will be very difficult to shorten the 105 day period under the New Regime unless the transaction before the target's shareholders results in an acquisition of the issuer or the issuer's
- business including for example, a change of control transaction, or forecloses the potential for higher bids;
- the use of tactical shareholder rights plans is very limited, and will almost always be cease-traded;
- the 5% Exemption is generally available to bidders absent unique circumstances that undermine the policies of the New Regime;
- lock-up agreements are a legitimate and established practice of M&A transactions and very important in the New Regime because of the increased deal risk created by the lengthier bid window and the minimum tender condition;
- as previously established, it is a question of fact whether a person is acting jointly or in concert with an offeror;
- a finding of acting jointly or in concert may arise in lock-up agreements where voting rights are granted to a bidder or benefits are granted to the locked-up shareholder outside of the obligation to make a bid at a price; and
- the transfer of clear and extensive material non-public information between a target and locked-up shareholders where the locked-up shareholders work together with the bidder to bring about a "planned result" may result in a finding of acting jointly or in concert.

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[1] 2028 OSEC 10[ps2id id='1' target=''/]

[2] McMillan LLP acts as counsel to Aurora, including in its application to the OSC and FCAAS and before the Panel.[ps2id id='2' target=''/]

[3] A tactical shareholder rights plan is one that is implemented by an issuer in the face of a threatened or existing take-over bid.[ps2id id='3' target=''/]

[4] These are agreements where a shareholder commits to tender to a bid so long as the price threshold is met; as opposed to " soft" lock-up agreements, where the shareholder is able to tender to a superior offer.[ps2id id='4' target=''/]

[5] (2006), 29 OSCB 6783[ps2id id='5' target=''/]

[6] (2007), 30 OSCB 6683, 2007 ONSEC 9[ps2id id='6' target=''/]

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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